

September 13, 2004

D.T.E. 04-30

Joint Petition of Massachusetts Electric Company and Nantucket Electric Company, pursuant to G.L. c. 25, § 19 and G.L. c. 25A, § 11G, for approval by the Department of Telecommunications and Energy of its 2004 Energy Efficiency Plan.

APPEARANCES: Amy G. Rabinowitz, Esq.
25 Research Drive
Westborough, MA 01582

FOR: MASSACHUSETTS ELECTRIC COMPANY AND
NANTUCKET ELECTRIC COMPANY
Petitioners

I. INTRODUCTION

On February 27, 2004, Massachusetts Electric Company and Nantucket Electric Company (together “MECo” or “Company”) filed with the Department of Telecommunications and Energy (“Department”) its Energy Efficiency Plan covering calendar year 2004 (“2004 Plan”).¹ MECo filed the 2004 Plan pursuant to G.L. c. 25, § 19, G.L. c. 25A, § 11G, and Order Promulgating Final Guidelines to Evaluate and Approve Energy Efficiency Programs, D.T.E. 98-100 (2000) (“DTE Guidelines”). The 2004 Plan includes programs for residential, low-income, and commercial and industrial customers. The Company proposes: (1) budgets for these programs; and (2) a method for calculating shareholder incentives that differs from those in the DTE Guidelines. On May 20, 2004, MECo filed an amendment to its 2004 Plan with respect to MECo’s 2004 Demand Response Initiative (deploying various technologies to reduce electrical load during peak hours).

On May 24, 2004, the Commonwealth of Massachusetts Division of Energy Resources (“DOER”) filed a report with the Department and the Company (“DOER Report”).² The DOER Report concluded that the 2004 Plan is consistent with the statewide energy efficiency goals required by G.L. c. 25A, § 11G, and with DOER’s Guidelines for energy efficiency

¹ MECo stated that the 2004 Plan is jointly submitted by MECo; the Associated Industries of Massachusetts, Inc.; Massachusetts Climate Action Network; and the Low-Income Energy Affordability Network (February 27, 2004 MECo letter to the Department).

² The Department commences review of energy efficiency plans after DOER files its report with the Department. G.L. c. 25A, § 11G; 225 C.M.R. § 11.00 et seq.; DTE Guidelines at § 6.2(3).

programs (DOER Report at 3). Oversight and Coordination of Electric Ratepayer Funded Energy Efficiency Activities, 225 C.M.R. §§ 11.00 et seq.

On June 3, 2004, the Department issued a notice of filing and request for comments. The Northeast Energy Efficiency Council filed comments urging the Department to approve Meco's plan.³

II. STANDARD OF REVIEW

The Department is required to ensure that energy efficiency activities are delivered in a cost-effective manner using competitive procurement processes to the fullest extent practicable. G.L. c. 25, § 19; G.L. c. 25A, § 11G. The Department has established guidelines that, among other things, set forth the manner in which the Department reviews ratepayer-funded energy efficiency plans in coordination with DOER, pursuant to G.L. c. 25, § 19 and G.L. c. 25A, § 11G. See D.T.E. 98-100.

DOER has the authority to oversee and coordinate ratepayer-funded energy efficiency programs, consistent with specified goals, and is required to file annual reports with the Department regarding proposed funding levels for said programs. G.L. c. 25A, § 11G; 225 C.M.R. §§ 11.00 et seq. If the DOER report concludes that ratepayer-funded energy efficiency programs are consistent with state energy efficiency goals, and if no objection to the DOER report is raised, the Department's review of the 2004 Plan is limited to

³ On its own motion, the Department moves into the record of this proceeding the 2004 Plan as revised on May 20, 2004. In addition, the Department incorporates by reference into the record of this proceeding the DOER Report. 220 C.M.R. § 1.10(3).

cost-effectiveness issues and the use of competitive processes. DTE Guidelines at § 6.2;

225 C.M.R. §§ 11.00 et seq.

III. 2004 ENERGY EFFICIENCY PLAN

A. Cost Effectiveness

Pursuant to the DTE Guidelines: (1) an energy efficiency program shall be deemed cost-effective if its benefits are equal to or greater than its costs, as expressed in present value terms; and (2) before implementation, each Program Administrator shall file with the Department sufficient information, including assumptions, to support the determination of cost-effectiveness for all proposed energy efficiency programs. DTE Guidelines at §§ 3.5, 4.2.1.⁴

To measure a program's pre-implementation benefits in comparison to its pre-implementation costs, MECo calculated a benefit/cost ("B/C") ratio for each of its proposed 2004 energy efficiency programs (2004 Plan at 10, App. A at 1). MECo reported pre-implementation B/C ratios ranging from 1.02 to 3.04 (id., App. A at 1). MECo also provided detailed cost and benefit information in support of each B/C ratio (id. at 2-3). Costs for each program were categorized in terms of program administration, implementation,

⁴ Each energy efficiency program is also subject to a post-implementation evaluation, addressing post-implementation estimates of energy savings, capacity savings, and other savings as well as post-implementation costs. Shareholder incentives are also determined as a result of the post-implementation evaluation. DTE Guidelines at §§ 4.1, 4.2.2, 5.3. For purposes of proper comparison, the Department directs the Company in future filings to report program benefits in its post-implementation evaluations consistent with the resource values used in its approved energy efficiency plans.

customer contributions, evaluation, and incentives (id.). Benefits for each program were categorized in terms of capacity, energy, and non-electric savings (id.).

B. Competitive Procurement

Pursuant to G.L. c. 25, § 19, the Department is required to ensure that the delivery of an electric company's energy efficiency programs uses competitive procurement to the fullest extent practicable. MECo provided a table illustrating the percentages of outsourced and competitively procured energy efficiency services for 2004 (2004 Plan at 9). According to MECo: (1) 82 percent of its residential energy efficiency services will be outsourced, and 97 percent of those residential outsourced services will be competitively procured; (2) 80 percent of its low-income energy efficiency services will be outsourced, and zero percent of those low-income outsourced services will be competitively procured;⁵ (3) 60 percent of its commercial and industrial energy efficiency services will be outsourced, and 95 percent of those commercial and industrial outsourced services will be competitively procured (id.). MECo asserts that 72 percent of its overall 2004 energy efficiency services will be outsourced and 83 percent of those outsourced services will be competitively procured (id.).

⁵ Residential low-income program activities must be "implemented through the low-income weatherization and fuel assistance program network" and therefore are not required to be competitively procured. G.L. c. 25, § 19; Massachusetts Electric Company and Nantucket Electric Company, D.T.E. 03-2, at 4-5 (2003).

C. Analysis and Findings

1. Cost-effectiveness

MECo provided evidence demonstrating that each of its proposed 2004 energy efficiency programs achieved a pre-implementation B/C ratio of 1.02 or greater (2004 Plan, App. A at 1). The Department notes that there were no individual programs with a pre-implementation B/C ratio below 1.00 (*id.*). The Department reviewed the detailed information provided in support of the Company's B/C calculations, and finds that the benefits and costs were determined consistent with Department criteria for establishing program cost-effectiveness. DTE Guidelines at §§ 3-4. Accordingly, the Department finds the Company's 2004 energy efficiency programs, as estimated in the pre-implementation phase, to be cost-effective.

2. Competitive Procurement

MECo provided evidence that it competitively procures and out-sources a high percentage of its energy efficiency program activities (2004 Plan at 9). Therefore, in accordance with G.L. c. 25, § 19, the Department finds that MECo's 2004 Plan provides for competitive procurement to the fullest extent practicable.

IV. SHAREHOLDER INCENTIVES

A. MECO's Shareholder Incentive Proposal

MECo proposed an alternative to the method set forth in the DTE Guidelines for calculating the after-tax shareholder incentives that may result from implementation of its 2004 Plan (2004 Plan at 100-103, App. B). See DTE Guidelines at § 5.00. The Company stated that its 2004 shareholder incentive proposal is supported by the Associated Industries of

Massachusetts, Inc. (“AIM”), Massachusetts Climate Action Network (“MCAN”), and the Low-Income Energy Affordability Network (“LEAN”) (2004 Plan at 100). MECo proposed to (1) fix the after-tax shareholder incentive at five percent; (2) set the threshold level of performance at 75 percent; (3) set the exemplary level of performance at 110 percent; and (4) slightly reallocate the weights assigned to the savings and value determinants (id. at 101-102).⁶

MECo stated that the proposed five percent after-tax incentive rate is necessary because the “very low prevailing Treasury bill rates may not provide an appropriate incentive to the electric distribution companies” (id. at 100).⁷ In 2004, the Company projects that it will have approximately \$53.7 million available to fund energy efficiency program efforts, including funding for the proposed performance incentive (id. at 4).⁸ Under its proposal, the Company estimated that its shareholder performance incentive would amount to approximately \$2.7 million based on energy efficiency expenditures of about \$53.7 million in 2004 (id. at 4, App. B).

⁶ In MECo’s 2003 Energy Efficiency Plan, the Department approved MECo’s use of (1) a fixed shareholder incentive rate of five percent, instead of the T-Bill rate in calculating its shareholder incentive and (2) a threshold performance level of 70 percent and exemplary performance level of 110 percent of design level for use in its calculations of shareholder incentives. Massachusetts Electric Company and Nantucket Electric Company, D.T.E. 03-2, at 16-19 (2003).

⁷ DOER notes that the yield on the three-month Treasury Bill has stayed at or below .91 percent from December 2003 through early 2004 (DOER Report at 4).

⁸ The \$53.7 million includes unspent funds carried over from MECo’s 2003 energy efficiency plan budget (2004 Plan at 4).

MECo stated that, if its threshold and exemplary proposal were approved, its shareholder incentive payment amount would range from 75 percent to 110 percent of its 2004 energy efficiency expenses (id. at 101, App. B). MECo presented evidence that a shareholder incentive would not be earned if an energy efficiency program failed to achieve the threshold level of 75 percent of design level performance, and that this threshold level is consistent with DTE Guidelines § 5.2 (id.).⁹ MECo stated that even if an energy efficiency program accomplished more than 110 percent of design level performance, the shareholder incentive for such a program would be capped at the 110 percent level (id. at 101-103).

Finally, MECo proposes to continue the use of a savings determinant, a value determinant, and performance metric determinant (id. at 101). Consistent with the previous practice of using these determinants, each determinant is assigned a percentage weight. Massachusetts Electric Company and Nantucket Electric Company, D.T.E. 03-2, at 13 (2003). MECo proposes a slight reallocation of the weight assigned to the savings and value determinants for 2004 (2004 Plan at 101). MECo proposes to weight savings and value determinants associated with its residential programs at 40 percent and 30 percent, respectively, instead of the 50 percent and 20 percent assigned and approved in D.T.E. 03-2 (id.). MECo proposes that savings and value determinants associated with its commercial and industrial programs be adjusted in the same manner as the residential programs, i.e., weights of 40 percent and 30 percent, respectively (id.).

⁹ DTE Guidelines set the threshold performance level at 75 percent and the exemplary performance level at 125 percent of a distribution company's design performance level. DTE Guidelines § 5.2.

B. DOER Report

DOER recommends adoption of the Company's 2004 shareholder incentive proposal (DOER Report at 4-5). DOER offers two reasons in favor of the proposal: (1) due to the precipitous decline in the three-month Treasury Bill rate, the performance incentive method prescribed in the DTE Guidelines is no longer adequate to motivate energy efficiency administrators to pursue the highest quality programs for ratepayers envisioned by the Legislature; and (2) the Department approved a similar proposal for MECo's 2003 Energy Efficiency Plan (id. at 4-5, citing D.T.E. 03-2).

C. Analysis and Findings

When an entity seeking Department approval of its Plan requests a different method from that specified in the DTE Guidelines, the burden falls on that entity to demonstrate the compelling nature of such a request. DTE Guidelines at § 1(2). In this proceeding, MECo has proposed (1) a fixed shareholder incentive rate of five percent, instead of the Treasury Bill rate in calculating its shareholder incentives and (2) an exemplary performance level of 110 percent of design level for use in its calculation of shareholder incentives; and (3) a slight adjustment to the weights assigned to the savings and value determinants.

The Department previously granted MECo and other distribution companies an exception to the DTE Guidelines that allowed the companies to use a fixed rate of five percent instead of the Treasury Bill rate in calculating its shareholder incentives. NStar Electric Company, D.T.E. 03-48, at 12 (2003); Fitchburg Gas and Electric Light Company, D.T.E. 03-44, at 12 (2003); Western Massachusetts Electric Company, D.T.E. 03-43, at 12 (2003); D.T.E. 03-2, at 17.

In determining incentive levels, the Department must reach a balance between two objectives: (1) promoting effective programs, and (2) protecting the interest of ratepayers. D.T.E. 98-100, at 21-22 (2000). While MECo's proposed five percent after-tax rate exceeds the rate now provided for in the DTE Guidelines, it is near the middle of the range that DOER proposed in D.T.E. 98-100, and this rate was approved for MECo's 2003 Energy Efficiency Plan in D.T.E. 03-2.¹⁰ The Department reaffirms that an incentive must be large enough to promote good program management, but small enough to leave almost all of the energy efficiency funds to directly serve customers. The Company's proposal balances these two objectives, and is consistent with DOER information that the Department used in formulating the DTE Guidelines. The Department finds that the Company has met its burden to demonstrate the need for its request for an alternate method to calculate shareholder incentives in 2004. DTE Guidelines at § 1(2). Accordingly, the Department grants MECo's request for an exception to the DTE Guidelines, and grants MECo's request to use five percent in calculating after-tax shareholder incentives for the 2004 Plan.

MECo's proposal to establish an exemplary performance level of 110 percent of design level is supported by DOER, AIM, MCAN, and LEAN. MECo raised the threshold performance level from the 70 percent approved in D.T.E. 03-43, to 75 percent, which is now in conformance with DTE Guidelines § 5.2. Also, in D.T.E. 03-2, the Department approved

¹⁰ DOER has maintained that an incentive of four to six percent, equal to a three to four percent riskless real rate of return plus an inflation rate of one to two percent, would be sufficient to motivate electric companies to manage energy efficiency programs well. D.T.E. 98-100, at 36.

the use of an exemplary performance level of 110 percent of design level for use in calculating shareholder incentives for 2003. In consideration of Department precedent, DOER's conclusions, and the support of energy efficiency stakeholders, the Department finds that the Company has demonstrated the reasonableness of its proposal to set the exemplary performance incentive level to 110 percent of performance goals. Accordingly, the Department accepts the Company's proposal to establish a threshold performance level of 75 percent, and to establish an exemplary performance level of 110 percent of design level for 2004.

Distribution companies may express the level of performance they expect to achieve in implementation of their energy efficiency programs in levels of savings, in energy commodity and capacity, and in other measures of performance as appropriate. DTE Guidelines at § 5.2. Here, the Company has established "other measures of performance." MECo proposes to continue the use of a savings determinant, a value determinant, and performance metric determinant, as approved in D.T.E. 03-2 (2004 Plan at 101). However, MECo proposes a slight reallocation of the weight assigned to the savings and value determinants for 2004 (id.). The Department recognizes that customers benefit when company programs perform at higher levels and at lower cost. We find that the Company's reallocation of weight assigned to the savings and value determinants is in accordance with that objective. Accordingly, the Department finds that the Company's proposed reallocation of the savings and value determinant weights for 2004 is appropriate. DTE Guidelines at § 5.2.

V. ORDER

Accordingly, after due notice, opportunity for public comment, and consideration, it is hereby

ORDERED: That the Petition of Massachusetts Electric Company and Nantucket Electric Company for approval of their Energy Efficiency Plan for 2004 is APPROVED; and it is

FURTHER ORDERED: That Massachusetts Electric Company and Nantucket Electric Company follow all other directives contained in this Order.

By Order of the Department,

/s/
Paul G. Afonso, Chairman

/s/
W. Robert Keating, Commissioner

/s/
Eugene J. Sullivan, Jr., Commissioner

/s/
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within 20 days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of 20 days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971.